

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO

IN RE)	
)	
DAVE SILVA, d/b/a NOS OTNOS,)	Case No. 93-02385
INC., and SHARON SELMASSKA,)	
a/k/a SHARON SILVA, d/b/a)	
NOS OTNOS, INC., d/b/a S & S)	
CLEANING,)	
)	
Debtors.)	
<hr/>)	
)	
BARBARA J. WUSSLER,)	
)	Adv. No. 94-06203
Plaintiff,)	
)	
vs.)	MEMORANDUM OF DECISION
)	RE CROSS MOTIONS FOR
DAVE SILVA, d/b/a NOS)	SUMMARY JUDGMENT
OTNOS,)	AND PLAINTIFF'S MOTION
)	TO AMEND COMPLAINT
)	
Defendant.)	
<hr/>)	

Jon S. Gorski, MOFFATT, THOMAS, BARRETT, ROCK & FIELDS,
Boise, Idaho and Richard C. Norton, San Diego, California, for
Plaintiff.

Laura E. Burri, RINGERT CLARK CHARTERED, Boise, Idaho and
Lawrence G. Sirhall, Jr., Boise, Idaho, for Defendant.

I. Background

Plaintiff Barbara Wussler initiated this adversary proceeding against Defendant Dave Silva, the Chapter 7 Debtor, on March 18, 1994. Wussler had obtained a California state court default judgment in June 1984 against Defendant, her former husband, in the amount of \$204,990.62. The default judgment was the result of litigation between Plaintiff and Defendant relating to ownership and control of the assets of a business known as The Court Room, Inc. and certain residential real property commonly referred to by the parties as the Solana Beach property. In this adversary proceeding, Plaintiff seeks a determination that her claim against Defendant under the default judgment should be excepted from Defendant's bankruptcy discharge under 11 U.S.C. § 523(a)(2)(A), (a)(4), or (a)(6).¹ The matter is before the Court on the motions for summary judgment filed by both Plaintiff and Defendant.

II. Facts.

The following appear from the record to be undisputed facts.

¹ In addition to her Motion for Summary Judgment, Plaintiff has also sought leave of the Court to amend her Complaint to include a cause of action under 11 U.S.C. § 523(a)(6).

Plaintiff and Defendant were formerly married and lived in New Jersey. Following their divorce in 1976, Defendant relocated to California where in 1978 he purchased a restaurant/lounge business known as "The Court Room" and the Solana Beach property. Later that year, Plaintiff joined Defendant in California at his invitation. While the parties did not formally reconcile, Defendant employed Plaintiff as the bookkeeper at The Court Room and Plaintiff lived at the Solana Beach property.

In 1981, Plaintiff filed a lawsuit against Defendant in California state court claiming, among other things, that Defendant was guilty of breach of contract, fraud, and conversion. The Court will not attempt to explain the specific allegations of the parties in that action, nor to describe the course of that litigation in detail. It is sufficient to note that the litigation was put on hold as the parties negotiated a settlement.

In early 1984, Defendant accepted a new job and moved back to New Jersey. For some reason, the litigation heated up again. On May 4, 1984, at Plaintiff's request, the state court issued an Order to Show Cause to Defendant directing him to appear at a hearing to show why he should not be held in contempt for failure to obey a prior discovery order. Copies of the proofs of service concerning this order reflect it was allegedly personally served on

Defendant in New Jersey and was also delivered to the offices of Defendant's counsel of record, Donald Rinaldo, a New Jersey attorney. Both Defendant and Mr. Rinaldo claim no personal knowledge of the existence of the show cause order or hearing and neither appeared at the hearing. They assert service of the order was defective and that the proofs of service are inaccurate or fraudulent.

When Defendant failed to appear at the show cause hearing on May 22, 1984, the court struck his Answer to Plaintiff's Complaint. On June 5, 1984, the state court entered default judgment against Defendant and his company, finding Defendant guilty of "oppression, fraud or malice." The judgment awarded Plaintiff damages totaling \$204,990.60, including approximately \$85,000 of punitive damages. The judgment also awarded ownership of The Court Room and Solana Beach property to Plaintiff. The court later authorized the clerk to execute the necessary documents to transfer title to these assets to Plaintiff. Defendant alleges he had no actual knowledge of the entry of judgment, and he denies having received a copy of the judgment prior to the filing of his bankruptcy proceedings and the initiation of this adversary proceeding.

Defendant remarried and moved to Idaho. He filed for Chapter 13 relief on August 13, 1993. His bankruptcy case was later converted at his

request to a case under Chapter 7 on January 5, 1994. Plaintiff commenced this action on March 18, 1994.

In August 1994, Plaintiff moved for summary judgment asserting that the California judgment was entitled to collateral estoppel effect in this adversary proceeding. In response, Defendant challenged the validity of the default judgment obtained in California against him. In a Memorandum of Decision issued on February 1, 1995, this Court abstained from making a determination as to the validity of the default judgment, and from any attempt to decipher its ambiguous language. *Wussler v. Silva*, 95 I.B.C.R. 19, 23. Instead, the Court directed the parties back to the California state court to resolve the dispute over the validity of the judgment and to obtain a clarification of the wording of that judgment for purposes of giving the judgment collateral estoppel effect. After four years and considerable additional expense and contest, the parties have returned. On December 18, 1998, the California court issued its decision in that litigation, which decision attempts to resolve the disputes concerning the default judgment.

Defendant filed a Motion for Summary Judgment in this adversary proceeding on March 23, 1999. At a hearing on Defendant's motion, this Court granted Plaintiff additional time within which to file a cross motion for summary

judgment, together with a motion to amend her complaint to include an additional cause of action. Plaintiff filed these motions on May 5, 1999.

III. Applicable Law.

Motions for summary judgment are governed by Rule 56 of the Federal Rules of Civil Procedure, made applicable here by Fed. R. Bankr. P. 7056. Summary judgment is appropriate if, after viewing the evidence in the light most favorable to the non-moving party, there is no genuine issue of material fact remaining and the moving party is entitled to judgment as a matter of law. Fed. R. Bankr. P. 7056; *State Farm Mutual Auto Ins. Co. v. Davis*, 7 F.3d 180, 182 (9th Cir. 1993); *FSLIC v. Molinaro*, 889 F.2d 899, 901 (9th Cir. 1989).

IV. Discussion.

Plaintiff and Defendant each rely, primarily, upon the state court judgment to show that as a matter of law Plaintiff is, or is not, entitled to have her claim against Defendant excepted from discharge.

A. Section 523(a)(2)(A).

Section 523(a)(2)(A) excepts from discharge a debt obtained through “false pretenses, a false representation, or actual fraud.” 11 U.S.C.

§ 523(a)(2)(A). To come within this provision, a creditor must prove, by preponderance of the evidence, see *Grogan v. Garner*, 498 U.S. 279, 291 (1991), that: (1) Defendant made representations; (2) which at the time Defendant knew were false; (3) Defendant made the representations with the intent to deceive Plaintiff; (4) Plaintiff relied on such representations; and, (5) Plaintiff sustained the alleged loss as the proximate result of the representations. *American Express v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1125 (9th Cir. 1996), *cert. denied* 520 U.S. 1230 (1997).

Plaintiff asserts that the default judgment should be afforded collateral estoppel effect in this bankruptcy proceeding. Collateral estoppel has been held to apply in bankruptcy discharge litigation. *Bugna v. McArthur (In re Bugna)*, 33 F.3d 1054, 1056 (9th Cir. 1994)(citing *Grogan v. Garner*, 498 U.S. 279, 284 & n. 11 (1991)). The determination of whether collateral estoppel effect should be given to a state court default judgment is a question of state law. *Bugna* at 1057. Here, California law governs that determination.

The Court must first address the validity of the default judgment. Defendant asserts that it is invalid, and therefore not entitled to respect in this action. Specifically, Defendant argues that the judgment expired and was not

timely renewed under applicable state law.² A judgment is valid under California law for a period of ten years. Cal. Code Civ. Proc. § 683.020. To renew a judgment, the holder must apply to the state court prior to the expiration of the ten-year period. Cal. Code Civ. Proc. § 683.130(a). The application must be served upon the judgment debtor and proof of service filed with the court. Cal. Code Civ. Proc. § 683.160(a).

Here, the judgment was entered on June 4, 1984. Judgment by Default: Declaration of Richard C. Norton in Support of Motion for Summary Judgment, Exhibit A. The judgment would therefore expire on June 5, 1994, in the absence of a timely application for renewal.³ Plaintiff filed such an application for renewal on June 6, 1994. This application was rejected by the state court as untimely. Plaintiff then filed a motion for relief from the order rejecting her application based upon her alleged excusable neglect on December 5, 1994, just within the six month period during which such a motion

² In a prior opinion, this Court determined that Plaintiff did not violate the automatic stay provisions by attempting to renew her judgment in California after Defendant had filed his bankruptcy petition in Idaho. *Wussler v. Silva (In re Silva)*, 215 B.R. 73, 76-77 (Bankr. D. Idaho 1997).

³ Under California law, time is computed by excluding the first day and including the last day of the period of time, unless that day is a holiday, upon which that day would also be excluded. Cal. Civ. Code § 10; Cal Code Civ. Proc. § 12.

may be made. Cal. Code Civ. Proc. § 473(b). The California court granted Plaintiff's motion and renewed the judgment.

This Court contemplated in its 1995 decision to abstain that any issues concerning alleged defects in the process used to renew the judgment would be resolved and clarified by the California court, being the court that issued the judgment and renewal. Unfortunately the state court did not conclusively resolve the issues. In its December 1998 decision, the California court denied Defendant's motion to set aside the judgment. However, the court also determined that the application to renew the judgment was not properly served on Defendant or his attorneys. Judgment: Declaration of Richard C. Norton in Support of Motion for Summary Judgment, Exhibit C at p. 4, ¶5. As near as this Court can tell, the California court purports to uphold a judgment that was not properly renewed under the state statute. However, because this Court invited the California court to make a determination, and since the California court considered Defendant's arguments concerning the alleged defective service of the renewal application and nevertheless upheld the judgment, this Court is in no position to review the California state court's decision, confusing as the result may seem. Accordingly, this Court accepts the

California court's determination that the default judgment was validly renewed and effective as of the date of Defendant's bankruptcy filing.⁴

The Court next considers whether the default judgment should otherwise be afforded collateral estoppel respect concerning the issues raised in this Section 523 action. The Supreme Court of California has instructed that collateral estoppel precludes relitigation of issues previously adjudicated if: (1) the issues necessarily decided in the previous suit are identical to the issues sought to be relitigated; (2) there was a final judgment on the merits of the previous suit; and, (3) the party against whom the plea is asserted was a party, or in privity with a party to the previous suit. *E.g., San Diego County Department of Social Services v. James J.*, 3 Cal. App. 4th 984, 993, 46 Cal. Rptr. 2d 491, 497 (1995).

Here, there could be a question whether the issues were actually litigated in California since the judgment was entered not after a trial, but by default. Contrary to the federal law which rejects the application of collateral estoppel to default judgments, California law embraces such an application.

⁴ Defendant asserted that Plaintiff's claims are barred under the applicable statute of limitations. However, given the determination that the Default Judgment is a valid judgment under state law, there appears to be no need to address the statute of limitations arguments as they relate to specific causes of action.

California courts have held that a default judgment satisfies the “actually litigated” requirement of collateral estoppel. *Lake v. Capps (In re Lake)*, 202 B.R. 751, 757 n.6 (9th Cir. B.A.P. 1996); *Four Star Electric, Inc. v. F & H Construction*, 7 Cal. App. 4th 1375, 1380, 10 Cal. Rptr. 2d 1, 3 (Ct. App. 1992).

The next inquiry is whether the issues sought to be litigated here are identical to those dealt with in the default judgment. The default judgment seems to address four distinct subjects. The judgment requires Defendant to: (1) transfer 100% of the stock in The Court Room to Plaintiff; (2) convey title to the Solana Beach property to Plaintiff; and, (3) to assign the so-called Karcich leases to Plaintiff. In addition, the state court found that under California Civil Code § 3294 Defendant was “guilty of oppression, fraud, or malice” and that this conduct justified an award of \$85,000 in punitive damages in Plaintiff’s favor.⁵

⁵ California Civil Code § 3294 provides that punitive damages may be awarded when “it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice.” The statute defines oppression, fraud, and malice. Oppression is “despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person’s rights.” Cal. Civ. Code § 3294(c)(2). Fraud is described as “an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.” Cal. Civ. Code § 3294(c)(3). Finally, malice is defined as “conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others.” Cal. Civ. Code § 3294(c)(1).

Judgment by Default: Declaration of Richard C. Norton in Support of Motion for Summary Judgment, Exhibit A at p. 2.

As it relates to the elements of Section 523(a)(2)(A), the default judgment finding of fraud seems to pertain only to the claim for punitive damages, not to the other claims or the entire judgment amount. The state court's finding of fraud in the judgment is also vague and equivocal. It is unclear whether the state court found Defendant guilty of oppression, fraud, malice, or of a combination of some, or of all three. This ambiguity led this Court in a prior decision to abstain from deciding the issues in response to Plaintiff's prior motion for summary judgment. See *Wussler v. Silva (In re Silva)*, 95 I.B.C.R. 19. In that decision, the Court encouraged the parties to return to California to litigate the validity of the judgment and to resolve any existing ambiguities.

In its decision dated December 18, 1998, the California court declared that the findings with respect to punitive damages were "vague, in the disjunctive and unintelligible and that the Court [could not] determine by its review of the 1984 judgment whether the punitive damages arose from, or otherwise relate to the first cause of action for fraud or the fifth cause of action for conversion." Judgment: Declaration of Richard C. Norton in Support of Motion for Summary Judgment, Exhibit C at p. 4. If the California court based its

award of punitive damages upon a finding that Defendant engaged in fraud, then there is little question that the judgment should be given collateral estoppel effect in this proceeding. On the other hand, if the punitive damages related to only the cause of action for conversion, then the default judgment would not meet the standards necessary to establish fraud under 11 U.S.C. § 523(a)(2)(A).

This Court must conclude that the default judgment does not conclusively show that the California court found Defendant guilty of fraud. Accordingly, the issues sought to be litigated here may in fact differ from those necessary to support the state court's judgment and collateral estoppel should not be applied to the judgment. Since genuine issues of material fact exist, Plaintiff's claim under Section 523(a)(2) is not ripe for summary judgment.

B. Section 523(a)(4).

Section 523(a)(4) excepts from discharge in bankruptcy any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). Under this provision, the term "fiduciary capacity" applies only to an express trust, a technical trust, or a statutory trust. *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1185 (9th Cir. 1996). The Court looks to state law to determine whether an express or technical trust exists. *Ragsdale*

v. Haller, 780 F.2d 794, 796 (9th Cir. 1986); *In re Abrams*, 229 B.R. 784, 789 (9th Cir. B.A.P. 1999).

“Federal law and not state law controls the definition of embezzlement for purposes of section 523(a)(4).” *First Delaware Life Insurance Co. v. Wada (In re Wada)*, 210 B.R. 572, 576 (9th Cir. B.A.P. 1997). In the context of dischargeability litigation, embezzlement is comprised of three basic elements: “(1) property rightfully in the possession of a nonowner; (2) nonowner’s appropriation of the property to a use other than which [it] was entrusted; and, (3) circumstances indicating fraud.” *Transamerica Commercial Finance Corp. v. Littleton (In re Littleton)*, 942 F.2d 551, 555 (9th Cir. 1991).

Larceny “requires a taking of property from the possession of another without his consent and with intent to permanently deprive him of possession.” *Burlington Industries, Inc. v. Wilson (In re Wilson)*, 114 B.R. 249, 252 n.10 (Bankr. E.D. Cal. 1990).

There is absolutely nothing in the judgment indicating the state court considered or decided any issue related to Defendant’s conduct as alleged fraud by a fiduciary, embezzlement, or larceny. Since it is impossible for this Court to determine whether or not the default judgment is indeed based upon such findings by the California court, the default judgment cannot be afforded

collateral estoppel effect in the context of Plaintiff's Section 523(a)(4) claim.

Thus, summary judgment is not appropriate.

C. Section 523(a)(6).

Plaintiff also requests relief under Section 523(a)(6), which excepts from discharge any debt for a willful and malicious injury by the debtor to another. 11 U.S.C. § 523(a)(6). However, Plaintiff failed to originally plead this claim and now seeks leave of the Court to amend her complaint to add the claim.

The amendment of pleadings is governed by Rule 15 of the Federal Rules of Civil Procedure, made applicable in bankruptcy proceedings by Fed. R. Bankr. P. 7015. Rule 15 provides in relevant part:

A party may amend the party's pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, the party may so amend it at any time within 20 days after it is served. Otherwise a party may amend the party's pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires.

Fed. R. Civ. P. 15(a).

Rule 15(a) instructs a court to grant leave when justice so requires.

"In exercising this discretion, a court must be guided by the underlying purpose of Rule 15 to facilitate decision on the merits, rather than on the pleadings or

technicalities.” *Roth v. Garcia Marquez*, 942 F.2d 617, 628 (9th Cir. 1991)(quoting *United States v. Webb*, 655 F.2d 977, 979 (9th Cir. 1981)). Accordingly, the policy of leave to amend should be applied liberally. *Ascon Properties, Inc., v. Mobil Oil Company*, 866 F.2d 1149, 1160 (9th Cir. 1989). Factors to be considered are whether the amendment: (1) will cause the opposing party undue prejudice; (2) is sought in bad faith; or (3) is futile. *DCD Programs, LTD., v. Leighton*, 833 F.2d 183, 186 (9th Cir. 1987). In addition, “an amendment can only relate back if the new claim relies on the same facts and does not seek to insert new facts.” *Magno v. Rigsby (In re Magno)*, 216 B.R. 34, 41 (9th Cir. B.A.P. 1997).

Allowing Plaintiff the opportunity to amend her complaint to include a claim under Section 523(a)(6) would cause little prejudice to Defendant since the operative facts involved are much the same as those related to Plaintiff’s claims under Section 523(a)(2) and (4). In addition, the Court accepts Plaintiff’s suggestion that she is not seeking to amend her complaint in bad faith. However, the “futility” element of the case law standard is important here. Plaintiff’s request is outside the time allowed to assert a claim under Section 523(a)(6). Under Rule 4007 of the Federal Rules of Bankruptcy Procedure a complaint under Section 523(c), including a claim under Section 523(a)(6), must

be filed within sixty days following the first scheduled Section 341(a) meeting of creditors. Fed. R. Bankr. P. 4007(c); 11 U.S.C. § 523(c). The question is whether Plaintiff is saved by Rule 15(c) of the Federal Rules of Civil Procedure, which allows an amendment to relate back to the time of the filing of an original pleading if “the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading” Fed. R. Civ. P. 15(c)(2). In this case, Plaintiff argues, and the Court agrees, that the Section 523(a)(6) claim is alleged to have arisen from the same conduct, transaction, or occurrence as the Section 523(a)(2)(A) and (a)(4) claims described in the Complaint. Therefore, Plaintiff’s motion to amend her complaint to include a cause of action under Section 523(a)(6) will be granted.

However, Plaintiff is not entitled to summary judgment on this claim. The Supreme Court has construed Section 523(a)(6) to require an act by a debtor akin to that of an intentional tort under state law, and the actor must intend the consequences or injury resulting from the act. *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S.Ct. 974, 977 (1998). This standard demands that a debtor commit more than a reckless or negligent act.

Once again, the state court judgment is silent as to any specific findings of intent on behalf of Defendant to cause injury to Plaintiff. The punitive damages in the default judgment could arguably have been based upon a cause of action for conversion with a specific finding of malice. If such were the case, this Court would have little trouble finding that collateral estoppel applied to the default judgment, since the definition of malice in California Civil Code § 3294 matches the *Geiger* standard under Section 523(a)(6). However, the punitive damages could also have been awarded for fraud under California Civil Code § 3294, which definition does not rise to the standard necessary under *Geiger*. Collateral estoppel cannot be applied to the default judgment with respect to the cause of action under Section 523(a)(6) and summary judgment is not appropriate for this claim.

Defendant's Motion for Summary Judgment seeks partial summary judgment that collateral estoppel is not available as to the default judgment. The Court agrees with Defendant, albeit for different reasons, and will grant partial summary judgment in favor of Defendant that collateral estoppel does not apply.

The remainder of Defendant's Motion for Summary Judgment will be denied. Defendant argues that if the default judgment is not given collateral estoppel effect, that the statute of limitations precludes litigating the issues again

in this proceeding. However, the state court has determined that Plaintiff holds a valid judgment which was effective as the date of Defendant's bankruptcy filing. Plaintiff timely filed her adversary proceeding in the bankruptcy case and should be afforded the opportunity to prove that her claims against Defendant under the default judgment may be excepted from discharge under Section 523(a)(2)(A), (a)(4), or (a)(6) of the Bankruptcy Code.

In addition, Defendant argues that the California court, in its December 18, 1998 ruling, held that the default judgment was not properly renewed. While it is not altogether clear from the court's decision, this Court does not agree. While the California court found that service was not properly effectuated, it did not void the judgment based upon that defective service. To the contrary, the California court expressly upheld the default judgment. For these reasons and except to the extent outlined above, Defendant's Motion for Summary Judgment will be denied.

V. Conclusion.

Although the California default judgment is valid and is conclusive evidence that Defendant is indebted to Plaintiff, the judgment cannot be afforded collateral estoppel effect with respect to Plaintiff's claims under Section

523(a)(2)(A), (a)(4), and (a)(6). The default judgment and the findings by the state court are vague and do not identify the specific reasons for the award of punitive damages, something which even the state court now acknowledges. This Court cannot determine that the issues important under Section 523(a) have previously been litigated by these parties in state court. Summary judgment is not appropriate under these circumstances and the matter must proceed to trial. At trial, while the state court judgment will establish that Defendant is indebted to Plaintiff, Plaintiff must rely upon other evidence to carry the burden of proving that her claims against Defendant are excepted from discharge.

A separate order will be entered granting Plaintiff's motion to amend her complaint to state a claim under Section 523(a)(6) and granting Defendant's motion for partial summary judgment that collateral estoppel does not apply to the default judgment. Plaintiff's Motion for Summary Judgment and the remainder of Defendant's Motion for Summary Judgment will be denied and the action will be set for further proceedings.

DATED this ____ day of June, 1999.

JIM D. PAPPAS
CHIEF U.S. BANKRUPTCY JUDGE

CERTIFICATE OF MAILING

I, the undersigned, hereby certify that I mailed a true copy of the document to which this certificate is attached, to the following named person(s) at the following address(es), on the date shown below:

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ADV. NO.: 94-6203

CAMERON S. BURKE, CLERK
U.S. BANKRUPTCY COURT

DATED:

By _____
Deputy Clerk